A Synopsis of Ph.D. work entitled

BANKING STATERGY OF COMMERCIAL BANKS IN CREDIT APPRISAL PROCESS WITH SPECIAL REFERENCE TO AURANGABAD DISTRICT

-: Submitted to :-

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INTRODUCTION :

Banking in its modern sense evolved in the 14th century in the rich cities of Renaissance Italy but in many ways was a continuation of ideas and concepts of credit and lending that had its roots in the ancient world. In the history of banking, a number of banking dynasties have played a central role over many centuries. The word *bank* was borrowed in Middle English from Middle French *banque*, from Old Italian *banca*,

A **bank** is a financial intermediary and money creator that creates money by lending money to a borrower, thereby creating a corresponding deposit on the bank's balance sheet. Lending activities can be performed directly by loaning or indirectly through capital markets. Due to their importance in the financial system and influence on national economies, banks are highly regulated in most countries.

The definition of a bank varies from country to country.Under English common law, a banker is defined as a person who carries on the business of banking, which is specified as -

- conducting current accounts for his customers,
- paying cheques drawn on him/her, and
- collecting cheques for his/her customers.

In most common law jurisdictions there is a Bills of Exchange Act that codifies the law in relation to negotiable instruments, including cheques, and this Act contains a statutory definition of the term *banker*: *banker* includes a body of persons, whether incorporated or not, who carry on the business of banking'. Although this definition seems circular, it is actually functional.

Statutory definitions:

- "Banking business" means the business of receiving money on current or deposit account, paying and collecting cheques drawn by or paid in by customers, the making of advances to customers, and includes such other business as the Authority may prescribe for the purposes of this Act; (Banking Act (Singapore), Section 2, Interpretation).

- "Banking business" means the business of either or both of the following:

  1. receiving from the general public money on current, deposit, savings or other similar account repayable on demand or within less than [3 months] ... or with a period of call or notice of less than that period;
  2. paying or collecting checks drawn by or paid in by customers.

Range of activities :

Activities undertaken by large banks include

- investment banking,
- corporate banking,
- private banking,
- insurance,
- consumer finance,
- foreign exchange trading,
- commodity trading
- trading in equities,
- futures and options trading and
- money market trading.

Channels :

Banks offer many different channels to access their banking and other services:

- Automated Teller Machines
- A branch is a retail location
- Call center
- Mail: most banks accept cheque deposits via mail and use mail to communicate to their customers, e.g. by sending out statements
- Mobile banking is a method of using one's mobile phone to conduct banking transactions
- Online banking is a term used for performing multiple transactions, payments etc. over the Internet
- Relationship Managers, mostly for private banking or business banking, often visiting customers at their homes or businesses
- Telephone banking is a service which allows its customers to conduct transactions over the telephone with automated attendant or when requested with telephone operator
- Video banking is a term used for performing banking transactions or professional banking consultations via a remote video and audio connection. Video banking can be performed via purpose built banking transaction machines (similar to an Automated teller machine), or via a video conference enabled bank branch clarification
- DSA is a Direct Selling Agent, who works for the bank based on a contract. Its main job is to increase the customer base for the bank.

BANKING IN INDIA :

Banking in India in the modern sense originated in the last decades of the 18th century. The among the first banks were Bank of Hindustan, which established in 1770. The largest bank, and the oldest still in existence, is the State Bank of India.

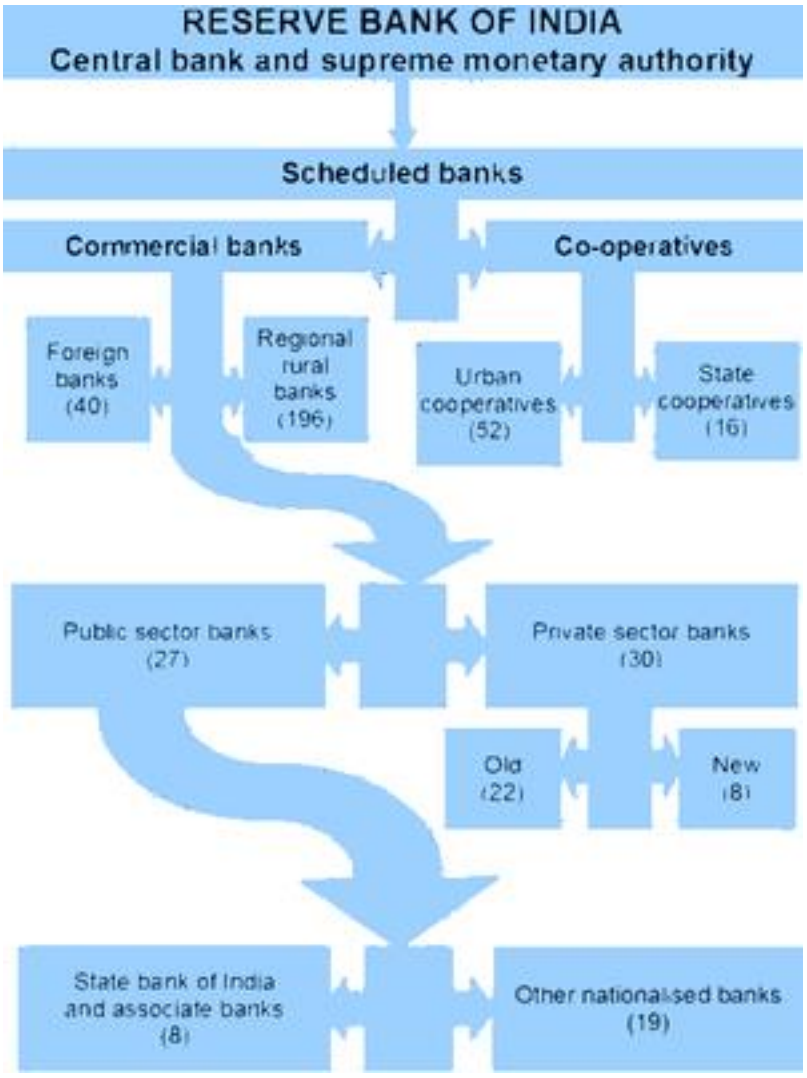

Fig.: Set up of Indian Banking Industry

Credit Apprisal Process :

The assessment of the various risks that can impact on the repayment of loan is credit appraisal. In short, you are determining "Will I get my money back?". Depending on the purpose of loan and the quantum, the appraisal process may be simple or elaborate. For small personal loans, credit scoring based on income, life style and existing liabilities may suffice. But for project financing, the process comprises technical , commercial, marketing, financial , managerial appraisals as also implementation schedule and ability.

Credit appraisal - It is the process by which the lender assesses the credit worthiness of the borrower. It revolves around character, collateral capability and capacity. It takes into account various factors like income of the applicants, number of dependents, monthly expenditure, repayment capacity, employment history, number of years of service and other factors which affect credit rating of the borrower.

Limitations of the Research:

The scope of the study is limited to only one district from Maharashtra state i.e. AURANGABAD District..Apart form chosen duration of research work secondary data not available respectively someyear and that will cover from primary level only. Along with, the implementing authorities will also form the part of study.

CREDIT APPRAISAL IN BANKING SECTOR :

WHAT IS CREDIT APPRAISAL?

Credit appraisal means an investigation/assessment done by the bank prior before providing any loans & advances/project finance & also checks the commercial, financial & technical viability of the project proposed.Proper evaluation of the customer is preferred which measures the financial condition & ability to repay back the loan in future Credit appraisal is the process of appraising the credit worthiness of the loan applicant.

WHAT IS CREDIT APPRAISAL? (CONT'D)

Factors like:-

» Age

» Income

» Number of dependents

» Nature of employment

» Continuity of employment

» Repayment capacity

» Previous loans, etc. are taken into account while appraising the credit worthiness of a person.

» Family background of borrower

3 ‘C’ of credit are must be kept in mind for lending funds:-

» Character

» Capacity

» Collateral

If any one of these are missing in the lending officer must question the viability of credit

RESEARCH METHODOLOGY

PROBLEM STATEMENT:

To study the Credit Appraisal Process in commercial banks.

OBJECTIVES:

- To study the Credit Appraisal Process
- To check the commercial, financial & technical viability of the project proposed & its funding pattern
- To check the primary & collateral security cover available for recovery of such funds

RESEARCH METHOLOGY (CONT'D)

» RESEARCH DESIGN : Analytical in nature

» DATA COLLECTION :

Secondary Data:

- E-circulars of banks
- Books & Journals
- Database at SBI
- Library research
- Websites

LIMITATION OF THE STUDY:

Due to the constraint limited study on the project has been done Access to data (Credit Appraisal data in detail is not available) As the credit appraisal is one of the crucial areas for any bank, some of the technicalities are not revealed which may cause destruction to the information

BRIEF OVERVIEW OF TYPES OF LOANS

Loans can be of two types fund based & non-fund based:

» FUND BASED includes:

- Working Capital
- Term Loan

» NON-FUND BASED includes:

- Letter of Credit
- Bank Guarantee

Debt Equity Ratio

Debt Service Coverage Ratio [DSCR]

Concept Proportion of Debt fund of a company in relation to its equity Formula Long Term Debt Tangible Net worth Comments This ratio is an indicator of leverage of a company It measures a company's ability to borrow and repay money Concept The amount of cash flow available to meet annual interest and principal payments Formula Net Operating Income Total Debt Service Comments DSCR less than 1 means negative cash flows MEASURES.

CREDIT RISK ASSESSMENT (CRA)

- The CRA models adopted by the Bank take into account all possible factors into appraising the risks, associated with a loan.
- These have been categorized broadly into financial, business, industrial & management risks are rated separately.
- These factors duly weighted are aggregated to arrive at a credit decision whether loan should be given or not

Financial parameters:

The assessment of financial risk involves appraisal of the financial strength of the borrower based on performance & financial indicators. which assessed in terms of static ratios, future prospects & risk mitigation .

CREDIT APPRAISAL PROCESS

- Receipt of application from applicant
- Receipt of documents (Balance sheet, KYC papers, Different govt. registration no., MOA, AOA, and Properties documents)
- Pre-sanction visit by bank officers
- Check for RBI defaulters list, willful defaulters list, CIBIL data, ECGC caution list, etc.
- Title clearance reports of the properties to be obtained from empanelled advocates
- Valuation reports of the properties to be obtained from empanelled valuer/engineers
- Preparation of financial data
- Proposal preparation
- Assessment of proposal
- Sanction/approval of proposal by appropriate sanctioning authority
- Documentations, agreements, mortgages
- Disbursement of loan
- Post sanction activities such as receiving stock statements, review of accounts, renew of accounts, etc (on regular basis)

CREDIT APPRAISAL STANDARDS

QUALITATIVE:

The proposition is examined from the angle of viability & also from the Bank's prudential levels of exposure to the borrower, Group & Industry View is taken about bank's past experience with the promoters, if there is a track record to go by Opinion reports from existing bankers & published data if available.

QUANTITATIVE:

(i)Working capital

(ii)Term Loan

Technical Feasibility

Economic Feasibility

Financial Feasibility

Managerial Competency

NORMS FOR CREDIT APPRAISAL

LOAN ADMINISTRATION – PRE SANCTION PROCESS

- Preliminary appraisal:

Sound credit appraisal involves analysis of the viability of operations of a business and the capacity of the promoters to run it profitably and repay the bank the dues The company's Memorandum and Articles of Association should be scrutinized carefully to ensure that there are no clauses prejudicial to the Bank's interests.

- Towards this end the preliminary appraisal will examine the following aspects of a proposal. Bank's lending policy and other relevant guidelines/RBI guidelines:

- Industry related risk factors

- Credit risk rating
- Profile of the promoters/senior management personnel of the project
- List of defaulters
- Caution lists
- Government regulations impacting on the industry
- Financial status whether it is acceptable
- Whether the project cost acceptable or not
- Debt/ Equity ratio whether acceptable
- Organizational set up with a list of Board of Directors & indicating the qualifications & experience in the industry
- Demand and supply projections based on the overall market prospects together with a copy of the market survey report
- Estimates of sales, cost of production and profitability
- Projected profit and loss account and balance sheet for the operating year
- Audited profit loss account and balance sheet for the past three years

LOAN ADMINISTRATION – POST SANCTION PROCESS

The post-sanction credit process can be broadly classified into three stages:

- Follow-up
- Supervision
- Monitoring

which together facilitate efficient and effective credit management and maintaining high level of standard assets

FINDINGS

- Bank loan policy contains various norms for sanction of different types of loans.
- These all norms does not apply to each & every case
- Bank norms for providing loans are flexible & it may differ from case to case.
- After case study, we found that in some cases, loan is sanctioned due to strong financial parameters.

From the case study analysis it was also found that in some cases, financial performance of the firm was poor, even though loan was sanctioned due to some other strong parameters such as the unit has got confirm order, the unit was an existing profit making unit & letter of authority was received for direct payment to the bank from ONGC which is public sector.

CONCLUSION

- Credit is the core activity of the banks & important source of their earnings which go to pay interest to depositors, salaries to employees & dividend to shareholders

- Credit & risk go hand in hand

- Bank's main function is to lend funds/ provide finance but it appears that norms are taken as guidelines not as a decision making

- A banker's task is to indentify /assess the risk factors/parameters & manage/mitigate them on continuous basis

Chapter Plan:

Chapter 1 - Introduction
Chapter 2 – Review of Literature
Chapter 3 – Overview of Credit Appraisal Process
Chapter 4 – Survey Results
Chapter 5 – Findings and Suggestions, Conclusions
Chapter 6 – References

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